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The development of strategic management in the non-profit context: Intellectual capital in social service non-profit organizations

Eric Kong

Very little systematic research has examined the applicability of strategic management concepts including SWOT (strengths, weaknesses, opportunities and threats) analysis, industrial organization, resource-based view and core competency, knowledge-based view, Balanced Scorecard and intellectual capital (IC) through the lens of strategic management development in the non-profit context. This paper aims to examine the above concepts in the light of the unique non-profit environment and determine which one is most applicable to social service non-profit organizations (SSNPOs) in the knowledge economy. Based on a review of the development of strategic management with a focus on the above concepts within the non-profit context, this paper argues that the IC concept is more effective compared with the other concepts in the social service non-profit sector. The paper is considered as a starting point and serves as a milestone in applying IC as a strategic management conceptual framework in the social service non-profit sector. It helps to build a nascent body of literature suggesting that IC can be used as a competent strategic management conceptual framework in the social service non-profit sector. A better understanding of the strategic management development in the non-profit context also helps non-profit leaders to appreciate that IC is the most appropriate strategic management concept in SSNPOs. The increased awareness of the IC concept in SSNPOs, as a result of this paper, will probably generate further research from both academic scholars and non-profit practitioners.

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Non-profit Challenge in the Knowledge Economy

The famous phrase 'Knowledge is power' (Kaplan 2002, 166) originated by Sir Francis Bacon in 1597 resonates with even more pertinence in today's knowledge economy. An Organization for Economic Co-operation and Development (OECD) report, *The Knowledge-Based Economy*, states that '[t]he determinants of success of enterprises, and of national economies as a whole, is ever more reliant upon their effectiveness in gathering and utilizing knowledge' (OECD 1996, 14). Researchers have highlighted the importance of knowledge as a key organizational resource that can lead to competitive advantages for an organization (Allee 1999; Wall *et al.* 2004; Wright *et al.* 2001). Thus, organizations that accumulate, apply and share knowledge are often perceived as leaders rather than followers and to succeed as opposed to fail in a knowledge-based economy.

Sir Francis Bacon's famous phrase is equally applicable to non-profit organizations (NPOs), which represent the larger umbrella of organizations in all non-profit fields, such as social services, animal welfare, culture and recreation, international and overseas aids, environment and personal development. Non-profit organizations pursue their mission to meet social needs, no matter how broadly or narrowly that mission might be interpreted (Liebschutz 1992). However, social service non-profit organizations (SSNPOs) will be the focus of this paper, because the organizations are particularly facing a crisis of independence now. Social service non-profit organizations are commonly operating in a highly competitive environment today that is characterized by increasing demand for services from the community (Kalisch 2000; Pierson 1998), growing competition for contracts with the public and for-profit sectors (Brown III 2005; Ramia and Carney 2003; Tuckman 1998), declining volunteer support (Clary and Snyder 1991; Lyons 2001; Lyons and Fabiansson 1998), and losing commitment from non-profit employees (Eisenberg 1997, 2000) and a generally tighter government funding

source (Craig *et al.* 2004; Flack and Ryan 2005; Keating and Frumkin 2003). Managing the social service non-profit sector has become much more complex (Chetkovich and Frumkin 2003; Goerke 2003). Many SSNPOs' cherished qualities, including independence and the ability to pursue social missions, are threatened (Chetkovich and Frumkin 2003; Craig and Manthorpe 1999; Craig *et al.* 2004; Goerke 2003; O'Neill and McGuire 1999).

The competitive environment has forced SSNPOs to adapt for-profit strategy concepts. However, these concepts are often criticized for being ineffective in SSNPOs (Alexander 2000; Chetkovich and Frumkin 2003; Mulhare 1999; Newman and Wallender III 1978; Paton *et al.* 2000; Weisbrod 1998). Eisenberg (1997, 334) argues:

Due to the heightened status and credibility of corporations in the eighties and the increased emphasis on management as a remedy for scarce resources and tight budgets, *much of the non-profit world has adopted some of the worst, not best, practices of corporat[ions]*. It has failed to distinguish between sound and ill-advised corporate policies, between for-profit and non-profit activities. Too often corporate-style management has become an end in itself, overshadowing the services to be delivered and the human qualities that characterise public service. [*emphasis added*]

As the primary objective of SSNPOs is investing in people rather than profit (Herman and Renz 1999; Ryan 1999), for-profit strategic management techniques are arguably compromising the principle of investing in human and social concerns. Accordingly, SSNPOs have not been able to make use of the strategy concepts to increase their effectiveness in serving their stakeholders. Although more literature has been pointing to the problems that NPOs face in the last three decades (e.g. Andreasen 1982; Garber Jr *et al.* 2000; Goldsmith 1979; Menefee 1997; Ritchie and Koldinsky 2003; Trigg and Nabangi 1995), there is relatively little written on what adapted strategic management methods are most appropriate for the pursuit of non-profit activities, particularly

in today's knowledge economy. The need for competent strategic management concepts that are able to fit into the unique non-profit environments has become widely accepted (Courtney 2002; Salamon *et al.* 1999; Steiner *et al.* 1994; Stone *et al.* 1999; Stone and Crittenden 1993).

Originally derived from for-profit strategic management techniques, intellectual capital (IC) has become a conceptually robust framework for NPOs. Unlike many other for-profit strategy concepts, IC stresses qualitative, non-financial indicators for future strategic prospects and may be harnessed to co-ordinate with the unique environment in which SSNPOs operate. Intellectual capital contributes to SSNPOs' strategic positioning by providing enhanced understanding of the allocation of organizational resources. Simultaneously, IC enables SSNPOs to enhance their performance by providing meaningful information to organizational stakeholders. In these ways, IC aids the organizations in their attempts to reconcile their social and commercial objectives.

This paper is divided into three main parts. First, it provides a brief outline of the development of strategic management in today's non-profit environment in the knowledge economy, including SWOT (strengths, weaknesses, opportunities and threats) analysis, industrial organization (I/O), resource-based view (RBV) and core competency, knowledge-based view (KBV) and Balanced Scorecard (BSC). It is argued that the concepts are inapplicable in the social service non-profit sector. Secondly, an overview of the emergence, the concept and the three component parts of IC is presented. Finally, the importance of IC in SSNPOs is reviewed. This paper argues that IC is an alternative strategic management conceptual framework within the unique non-profit environment in the social service non-profit sector.

The Development of Strategic Management in the Non-profit Context

Strategic management can be interpreted as a set of managerial decisions and actions of an organization that can be used to facilitate

competitive advantage and long-run superior performance over other organizations (Powell 2001; Wheelen and Hunger 2004). Thus strategic management involves a number of critical steps, including 'scanning the environment for information, selecting relevant data and interpreting it, building a strategic model, testing it and putting it into action' (Cray and Mallory 1998). The development of the field of strategic management within the last three decades has been dramatic (Hoskisson *et al.* 1999; Wright *et al.* 1994), witnessing the transformation from an industrial-based economy that emphasizes product manufacturing as the necessity for the economic system to a knowledge-based economy that focuses on the production, distribution and use of knowledge and information (Bettis and Hitt 1995; OECD 1996). A better understanding of the development of strategic management in the light of the unique non-profit environment is important to SSNPOs, as it assists non-profit leaders to select a strategic management concept which is most appropriate to their organizations in today's knowledge economy.

Strengths, Weaknesses, Opportunities and Threats

The emergence of strategic management can be traced back to the 1950s, when Selznick (1957) introduced the need to bring an organization's 'internal state' and 'external expectations' together for implementing policy into the organization's social structure. Andrews (1971) defined strategy as the balance of actions and choices between internal capabilities and the external environment of an organization. Wehrich (1982) further conceptualized the internal and external analysis into a structured matrix known as the SWOT framework, which enquires into the strengths, weaknesses, opportunities and threats of an organization.

The SWOT analysis remains as a strategic management framework in some organizations today because it has a long history in the strategic management field (Mintzberg *et al.* 1998). More importantly, the framework is rather simple to adopt, with basically no investment

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required when it is used, and very little specialized skill involved in facilitating the strategy formulation process. This is particularly essential to SSNPOs because these organizations often operate under tremendous financial constraint as a result of the public sector reform movement.

However, the prevailing SWOT analysis process has been criticized for its simplicity and generalization (Valentin 2001), indiscriminate lists involving typical procedural guidelines that lack explicit theoretical underpinnings (Fahy and Smithee 1999; Ip and Koo 2004), and the rigid descriptive nature of meandering haphazardly from one standalone SWOT variable to another, which often dangerously generates misleading results in the strategic management process (Hill and Westbrook 1997; Lee *et al.* 2000) and stifles creativity and vision in organizations (Patrickson and Bamber 1995).

Managing a SSNPO strategically is arguably more difficult than in a for-profit or public sector organization in today's knowledge economy, because SSNPOs often find themselves caught in the crossfire of conflicting multiple constituencies under the public reform movement (Sandler and Hudson 1998). Also, it requires more knowledge and skills to manage effectively the combination of both paid employees and volunteers in SSNPOs than it does to manage effectively an entirely paid staff or a staff consisting solely of volunteers (Cunningham 1999; Kong 2003; Lyons 2001). Thus, the efficacy of the SWOT analysis procedure as a strategic management framework to provide sufficient strategic insights and analysis for non-profit decision-makers remains questionable in the non-profit environment.

As the development of strategic management continued, the SWOT framework began to proceed down two separate ways, with one path representing opportunities and threats, and the other focusing on strengths and weaknesses (Zack 2005).

Industrial Organization

The path of opportunities and threats is commonly known as industrial organization (I/O)

or industry economics, which emphasizes the external environmental determinants of organizational performance (Porter 1985, 1996, 1998). There are two assumptions in the environmental models of competitive advantage (Barney 1991; Bontis 2002). First, firms within an industry are identical in terms of the strategically relevant resources they control and the strategies they pursue (Porter 1981; Rumelt 1984). Secondly, these models assume that resources in an industry are heterogeneous because the resources that organizations use to implement strategies are highly mobile in the market (Barney 1991; Bontis 2002). The I/O school of strategy stresses choosing an appropriate industry and positioning an organization within that industry according to a generic strategy of either low cost or product differentiation (Zack 2005).

However, SSNPOs that adopt the I/O school of strategy are induced using market logic to demonstrate their differences from competitors in their field (Barman 2002; Crouch 2003; Goold 1997). They are urged to do a better job of positioning and differentiating their services in the sector (Chetkovich and Frumkin 2003) so that they can convince their stakeholders, especially fund providers, that they deserve resources more than their competitors do (Barman 2002). Differentiation leads to the construction of a hierarchy of comparison between SSNPOs and their competitors according to certain measures or criteria such as cost and benefit calculus or bottom-line measurement, in which SSNPOs attempt to come out at the top of the hierarchy (Barman 2002). However, the organizations often have goals that are amorphous and offer services that are intangible (Forbes 1998). Accordingly, the success of SSNPOs cannot be measured by how closely the organizations keep to budgeted spending (Barman 2002; Kaplan 2001).

Also, the I/O school has been criticized for focusing primarily on the environmental determinants of organizational performance and missing the significance of the unique characteristics of individual organizations, such as managers' capabilities to contribute to organizational performance (Barney 1991; Wright

et al. 1994; Zack 2005). In today's knowledge economy, non-profit organizational members' knowledge and skills are critical to their organizations. For this reason, the I/O school of strategy is deemed to be inapplicable in the non-profit landscape.

With the emerging role of internal organizational capabilities, the pendulum of strategic management development has swung from external to internal aspects of an organization (Collis and Montgomery 1995; Hoskisson *et al.* 1999).

Resource-based View and Core Competency

A new entrant that emerged in the early 1980s but was increasingly noticeable in the 1990s was the resource-based view (RBV), which stressed the internal capabilities of firms (Barney 1991; Conner 1991; Peteraf 1993; Wernerfelt 1984). The underpinning concept of the RBV is that no two organizations are identical, because no two organizations have acquired the same set of organizational resources such as capabilities, skills, experiences and even organizational cultures (Collis and Montgomery 1995). Thus, organizations must possess organizational resources with attributes that are rare, valuable, costly to imitate and non-substitutable, which allow them to hold the potential of sustained competitive advantage over other competitors (Barney 1991; Hoskisson *et al.* 1999). A resource-based approach to strategic management focuses on the costly-to-copy attributes of an organization as the fundamental drivers of performance and competitive advantage (Bontis 2002; Conner 1991; Michalishn *et al.* 1997; Peteraf 1993; Wernerfelt 1984).

The theory of core competence, which allows organizations to rethink, identify, exploit what they can do to make growth possible in global competition, began to emerge as a subset of the RBV of a firm (Hamel and Prahalad 1994; Prahalad and Hamel 1990). Prahalad and Hamel (1990, 79) define a core competence as 'the collective learning in the organization, especially the capacity to coordinate diverse

production skills and integrate streams of technologies'. Thus competencies include a bundle of human resource elements such as experience, skills and education (Bontis *et al.* 2000). It is the emphasis of competencies and capabilities on the organizational processes that is difficult for competitors to reproduce or imitate (Guerrero 2003).

However, RBV and core competency have their limitations. Both theories predominantly focus on the internal aspects of organizations (Bontis 1999, 2002; Roos *et al.* 1997). Peppard and Rylander (2001b) argue that RBV does not provide a holistic perspective for understanding how resources can be put into practice to create value for organizations, which has limited the theory as mostly a conceptual framework. The theory of core competence views that the 'value of the talented people' is more valuable because it is part of an organizational system (Mouritsen 1998, 468). Although members in an organization may have considerable insights and experiences, such insights and experiences must be translated into an organizational domain as a public body of knowledge for the organization (Thompson 1967). The value of non-human aspects of an organization, such as information technology, seems to be overlooked.

The special characteristics of SSNPOs such as the combination of paid staff and volunteers and accountability of multiple constituents have made the strategic management process in the organizations more complex than that in for-profit and government organizations (Chetkovich and Frumkin 2003; Goerke 2003). Besides, knowledge about the nature of an environment is an essential ingredient in the strategic management process because it provides opportunities and threats to organizations (Patrickson and Bamber 1995). The theories of RBV and core competence which stress internal capabilities may not be able to provide a balanced picture of how a SSNPO is performing.

As the development of strategic management continued, the demand for a strategic management framework that was able to blend internal capabilities and external environment increased.

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Some strategic management theorists such as Liebeskind (1996), Sveiby (2001), von Krogh and Roos (1995, 62) and Zack (1999, 2005) have proposed a link between knowledge and strategy, arguing that knowledge helps to improve the internal strengths and maximize the external opportunities of an organization. As will be seen in the next section, knowledge is the strategic resource for all organizations.

Knowledge-based View

In many respects, the development of strategic management thinking, at least to some extent, has been influenced by the significance of the economic role of 'knowledge'. Nelson and Winter (1982) introduced environmental studies researcher Michael Polanyi's (1997) concepts of tacit-explicit knowledge into the strategic management literature. Tacit knowledge refers to the knowledge that is 'non-verbalized, or even non-verbalizable, intuitive, unarticulated' (Hedlund 1994, 75) and thus is not easily expressed and formulated (Baumard 2002; Yates-Mercer and Bawden 2001). Explicit knowledge is specified 'either verbally or in writing, computer programs, patents, drawings or the like' (Hedlund 1994, 75). Both tacit and explicit knowledge exist in individual, group, organizational and inter-organizational domains (Davenport and Prusak 1998; Hedlund 1994).

As valuable, rare and inimitable resources are usually intangible and implicit in nature, value creation is increasingly dependent on the tacit knowledge that an organization controls (Kaplan and Norton 2001). Tacit knowledge has become the central theme in the strategic management literature not only because it is a meaningful resource for organizations, but also is a critical strategic source of sustained competitive advantage, which enhances organizational performance (Ambrosini and Bowman 2001; Conner and Prahalad 2002; Mertins *et al.* 2001; Michalish *et al.* 1997).

Organizations that are able to use knowledge effectively, notably tacit knowledge, are more likely to co-ordinate and combine their traditional resources and capabilities in new

and distinctive ways, providing more value for their customers than their competitors (Teece *et al.* 1997). The perspective of utilizing knowledge as the primary source of competitive advantage became known as the knowledge-based view; an extension of the RBV (Bontis 2002; Conner and Prahalad 2002; Grant 1997; Spender 1996b; Wiklund and Shepherd 2003). Spender (1996a, 59) argues that a KBV 'can yield insights beyond the production-function and resource-based theories of the firm by creating a new view of the firm as a dynamic, evolving, quasi-autonomous system of knowledge production and application'.

However, the limitation of KBV is that it conceives both tacit and explicit knowledge as an objectively definable commodity (Empson 2001). The KBV implies that knowledge is a static internal resource in organizations, which can be controlled, exploited and traded like most physical resources (Styhre 2003). As a result, information systems are often developed attempting to capture, store, retrieve and transmit knowledge between units, departments, organizations and individuals (Bettis and Hitt 1995; Styhre 2003). However, knowledge cannot be regarded as a static resource (Yates-Mercer and Bawden 2001). Even though knowledge can realistically be accumulated and stored, it may not create superior values to organizations, because it is not primarily the stocks of knowledge but the transformation of knowledge into a process, business plan, good reputation or strong culture that creates values for organizations (Cook and Yanow 1993; Peppard and Rylander 2001b). This flow of knowledge is extremely essential to organizational success (Boedker *et al.* 2005). Accordingly, an information technology approach which focuses on accumulating and storing knowledge may not be able to create truly sustainable competitive advantage unless knowledge flows backwards and forwards, within and between an organization and its external stakeholders (Fahey and Prusak 1998; Sveiby 2001).

Though the knowledge-based perspective which views knowledge as an asset is an important concept, the perception, to a certain

extent, becomes distorted as too much focus is on the development of information technology (Hendriks 2001; Ipe 2003), which limits the growth of visualizing and understanding of intellectual aspects, particularly tacit knowledge, for value creation in organizations. This also applies to SSNPOs.

Various methods have been suggested to visualize and understand organizational intellectual resources, including the Balanced Scorecard™ (BSC), human resource accounting (HRA), market-to-book values, Tobin's Q and economic value added (EVA) theory, etc. Of these, only the BSC will be discussed in this paper. There are three justifications for this focus. First, some attempts have been made to apply BSC in the non-profit sector, although requiring some modifications (Kaplan and Norton 2004; Niven 2003). However, the state of knowledge on the role of BSC as a strategic management method in the non-profit sector is not well developed. There is a need to examine the effectiveness and suitability of BSC in NPOs, particularly with the emerging importance of knowledge and skills in the social service non-profit sector.

Secondly, BSC is the only method which does not predominantly focus on intellectual resource measurement or intangible assets valuation. The issue of measurement is important. However, evaluating the financial value of intangible assets in SSNPOs is not only difficult, but also incompatible with the primary objective of SSNPOs. For instance, it is very difficult and yet possibly against the social objective of a child-care SSNPO to focus on evaluating the financial outcome of bringing joy and happiness to children with life-threatening illness. Finally, the measuring aspect of intellectual resources in SSNPOs is not within the scope of this research study. Thus, BSC is the only strategic management method that is reviewed in relation to its applicability in SSNPOs in this paper.

Balanced Scorecard

The BSC was first introduced by Robert Kaplan and David Norton as a tool for business

organizations to convert intangible assets such as corporate culture and employee knowledge into tangible outcomes (Kaplan and Norton 2000). It includes a set of measures to monitor organizational performance across four linked perspectives: financial, customer, internal process and learning and growth (Kaplan and Norton 1992, 1996, 2000).

It is the cause-effect relationships among the four measures, both financial and non-financial, that distinguish BSC from other strategic management systems (Bontis *et al.* 1999; Nørreklit 2000; Wall *et al.* 2004) because, as claimed, financial measures provide information about past performance, while non-financial measures are able to drive future performance (Kaplan and Norton 1996). In short, BSC helps to bring forth intellectual resources in organizations (Bontis *et al.* 1999; Petty and Guthrie 2000).

Today, the BSC is widely used in the for-profit and public sectors (Bryson 2005; Wall *et al.* 2004). Kaplan (2001) claims that BSC enables NPOs to bridge the gap between mission and strategy statements and day-to-day operational actions by facilitating a process by which NPOs can achieve strategic focus. However, there are a number of reasons to suggest that BSC offers an inferior framework for the non-profit context, particularly in the social service non-profit sub-sector.

First, BSC proposes a strategy which is formulated and executed under the assumptions that presupposed existence of a stable target group of customers are always in place (Mouritsen *et al.* 2005) and the maximization of bottom-line profitability between two competing organizations always exists (Crouch 2003; Goold 1997). However, the concept of customers does not really exist in the social service non-profit sector because SSNPOs are often accountable to multiple constituents. This means that the beneficiaries of the non-profit services are typically different from those who provide material support (Brown and Kalegaonkar 2002; Lyons 2001). For instance, government purchases services from SSNPOs, and other group of people are the final users of services. Thus, SSNPOs do not have customers but only service recipients.

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The SSNPO's mission is perceived as a moral absolute rather than as an economic prerogative subject to a cost and benefit calculus (Guy and Hitchcock 2000). Serving the public is an obligation, not an option for the organizations. Accordingly, strategic management approaches that are based primarily on the notion of competitions and customers are generally unacceptable to the social service non-profit sector.

Secondly, there is a concern that the cause-and-effect relationships among the four BSC perspectives are logical rather than causal (Bontis *et al.* 1999; Nørreklit 2000, 2003). It is always assumed in BSC that *learning and growth* drives efficient *internal process*, then that drives a high level of *customer satisfaction*, and that drives good *financial* outcomes (Nørreklit 2000). The assumption about the logical cause-and-effect relationships is less convincing in SSNPOs because the organizations are accountable to multiple constituents. The expectations and demands of various constituent groups associated with the organizations are often conflicting and even contradictory (Lawry 1995). As a result of that, it almost guarantees that the cause-and-effect relationships do not work in SSNPOs because logical fallacies could lead to an inaccurate anticipation of performance indicators (Nørreklit 2000, 2003).

Thirdly, BSC is criticized for being fairly rigid because the four linked perspectives and the indicators within them are relatively limiting (Bontis *et al.* 1999). The potential risk is that non-profit leaders and managers may be misled by focusing only on the four perspectives in BSC and may end up missing other equally important factors in their organizations (Bontis *et al.* 1999). A fine example of this is the very reason that most SSNPOs exist, and that is the social purpose for the betterment of society that the organizations aim to achieve in the first place. This key factor is not reflected in the BSC model.

There are also shortcomings for the individual perspectives when applying them in SSNPOs. The considerations on the external environment

in BSC are only limited to customers (Bontis *et al.* 1999; Petty and Guthrie 2000). Also, there is no clear-cut human resource element focus in the four BSC perspectives. The issues in the social service non-profit sector are rendered complex under the public sector reform movement. Thus, the possible external indicating factors for SSNPOs are likely to be broader than that in the *customer* perspective of BSC, and the importance of the innovativeness and talents of employees and volunteers in SSNPOs may be diminished significantly. As already mentioned, the ability of SSNPOs to achieve their objectives depends almost entirely on the knowledge, skills and experience of their paid employees and volunteers (Hudson 1999). Many SSNPOs, in fact, rely heavily on voluntary labour (Hudson 1999). The unclear cut of human resource element focus in the four BSC perspectives may discourage talented individuals from joining the organizations, because they may feel that their efforts for the organizations are not recognized under the BSC model.

Finally, financial and non-financial performance indicators are likely to be negatively related because non-financial indicators focus on future investments, and financial measures stress present and historical performance (Juma and Payne 2004). Accordingly, BSC may not be appropriate in SSNPOs under the unique non-profit environment in the knowledge economy, as it is likely to mislead non-profit leaders and managers to focus more on short-term financial objectives rather than long-term intellectual resource investments.

Even Kaplan and Norton admit that applying BSC in NPOs is different from that in business organizations because NPOs strive to deliver value driven mission that is subject to interpretation, not superior financial performance (Kaplan 2001; Kaplan and Norton 2004). They claim that they have modified the BSC specifically for the unique non-profit environment (Kaplan and Norton 2004). This paper, however, argues that the modified BSC does not resolve the problems discussed above. The modified BSC becomes even more confusing.

The confusion starts with the financial perspective being replaced in the modified model by a fiduciary perspective, which reflects the objectives of other constituents such as donors and taxpayers.

Kaplan and Norton (2004) claim that both financial and customer stakeholders need to be satisfied concurrently. Therefore, both customer and fiduciary perspectives are located on the same level, which, however, does not fit in the original cause-and-effect relationship principle. The two perspectives (fiduciary and customer) are not connected. As a result, there may be a misconception that service recipients are not important to donors and taxpayers, or that the latter are not concerned with the needs of the service recipients. However, both donors and service recipients are, in fact, closely linked together, and their needs and expectations from the two sides do not necessarily have to be in the same direction. Therefore, meeting the needs of both the financial and customer stakeholders simultaneously is not just difficult, sometimes it is impossible.

Although the BSC model has witnessed a big step in the strategic management development in terms of visualizing their knowledge and skills in NPOs, the model itself is not compatible with the unique non-profit environment in the knowledge economy. As Backman *et al.* (2000, 4) argue:

[a]lthough elements of the current [strategic management] models make sense at a general level, they are not sufficiently nuanced and sensitive to the unique environments of non-profits ... [and thus,] ... there [is] a large *conceptual gap* between the strategy models available to organizations in the non-profit and for-profit sectors ... the non-profit strategy models do not, as yet, offer a conceptually robust frame for widespread adoption by practitioners. [*emphasis added*]

The main reason for the conceptual gap, as identified by Backman *et al.* (2000), is that the strategic management concepts used in SSNPOs do not address the social dimension and/or distinctive nature of competition and collaboration in non-profit settings. In contrast

to the situation in for-profit organizations, a major part of a non-profit leader's responsibility is to consider the effect of strategy on a charitable or mission rather than simply on financial performance (Alexander 1999; Guy and Hitchcock 2000; Ryan 1999). A strategy that sacrifices mission for greater margin will eventually become untenable, as it most likely alienates stakeholders such as service recipients and the general public in the social service non-profit sector (Alexander 2000; Courtney 2002). In this sense, there is little connection between contemporary strategic management concepts and the social missions pursued by SSNPOs (Chetkovich and Frumkin 2003). Accordingly, the effectiveness of the contemporary strategic management concepts in the sector is greatly reduced (Alexander 2000; Crouch 2003; Lyons 2001).

In short, the development of strategic management in the non-profit context has been equally as dramatic as in the for-profit sector, if not more so. Figure 1 briefly illustrates the development of strategic management in the non-profit context as discussed in this section.

The Need for a Competent Strategic Management Framework in SSNPOs

The urgency of developing a new, more complex strategy management technique which reflects the challenges and messy realities that non-profit leaders face every day is increasingly

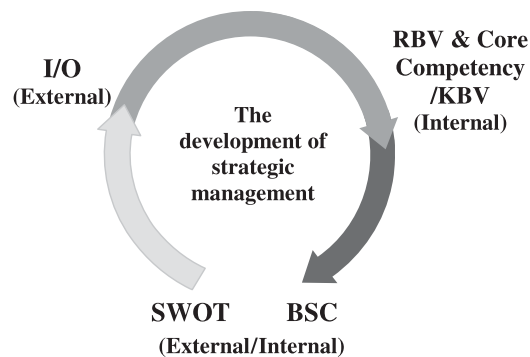


Figure 1. The development of strategic management in the non-profit context.

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pressing (Backman *et al.* 2000; Salamon *et al.* 1999; Stone *et al.* 1999). This new and complex non-profit strategic management framework not only should help SSNPOs to improve their performance, but also to preserve and regain their cherished qualities. As Salamon *et al.* (1999, 37) suggest:

[NPOs] need to be able to demonstrate the worth of what they do, and to operate both efficiently and effectively in the public interest. *This will require something more than traditional management training, or the wholesale adoption of management techniques imported from the business or government sector. Rather, continued effort must be made to forge a distinctive mode of non-profit management training that takes account of the distinctive values and ethos of this sector while ensuring the effectiveness of what it does.* [emphasis added]

The distinctive mode of non-profit management training as described above can be interpreted as a competent strategic management technique that can be used to assist SSNPOs in achieving effective performance and, at the same time, sustaining the distinctive values and ethos of the sector. Light (2002, 19) argues that '[NPOs] are not corporations, small businesses, governments, faith-based organisations, or firms, even if they behave like all of the above from time to time. They are non-profits and must become more non-profit like if they are to choose their future'. Therefore, SSNPOs must develop a special kind of strategy that can assist them to achieve high performance (Letts *et al.* 1999); that is, to achieve social purposes under the current turbulent changes and, at the same time, emphasize the cherished qualities of the organizations (Frumkin and Andre-Clark 2000; Moore 2000). Such a strategy is not only about what an organization intends to do but is also concerned with what the organization decides not to do (Kaplan 2001). This is important to SSNPOs, as these organizations today live a 'hand-to-mouth existence' under the public sector reform movement (Lyons 2001).

Although highly supportive of the notion that SSNPOs need to be managed strategically, this paper takes a step further by arguing that the

organizations must place the social dimension at the centre of their strategy, as the social dimension is often the *raison d'être* of SSNPOs' existence in society. This paper argues that, unlike other for-profit strategic management concepts, the concept of IC can be used as a competent strategic management conceptual framework in the social service non-profit sector, in particular in today's knowledge economy.

Intellectual Capital

The IC Concept and Its Components

Stewart (1997) defines IC in terms of organizational resources relating to wealth creation through investment in knowledge, information, intellectual property and experience, while it is defined by Edvinsson and Malone (1997, 44) as 'the possession of knowledge, applied experience, organizational technology, customer relationships and professional skills that provide ... a competitive edge in the market'. Following the work of a number of scholars in the field of IC, IC encompasses three primary inter-related, non-financial components: human capital (HC), structural capital (SC) and relational capital (RC) (Bontis 1998; Roos *et al.* 1997; Stewart 1997).

Human capital includes various human resource elements, including attitude, competencies, experience and skills, tacit knowledge and the innovativeness and talents of people (Choo and Bontis 2002; Guerrero 2003; Roos and Jacobsen 1999). It represents the tacit knowledge embedded in the minds of people in organizations (Bontis 1999; Bontis *et al.* 2002). It is important to organizations as a source of innovation and strategic renewal (Bontis 2002; Bontis *et al.* 2000; Webster 2000). A higher level of HC is often associated with greater productivity and higher incomes or compensation (Wilson and Larson 2002). It is therefore in the interests of human resource managers to recruit and develop the best and brightest employees as a means of achieving competitive advantage (Bontis *et al.* 2002).

Structural capital refers to the learning and knowledge enacted in day-to-day activities. The pool of knowledge that remains in an organization at the end of the day after individuals within the organization have left represents the fundamental core of SC (Grasenick and Low 2004; Roos *et al.* 1997). It becomes the supportive infrastructure for HC. It includes all the non-human storehouses of knowledge in organizations such as databases, process manuals, strategies, routines, organizational culture, publications and copyrights which create value for organizations, thus adding to the organizations' material value (Bontis *et al.* 2000; Ordóñez de Pablos 2004).

Relational capital characterizes an organization's formal and informal relations with its external stakeholders and the perceptions that they hold about the organization, as well as the exchange of knowledge between the organization and its external stakeholders (Bontis 1998; Fletcher *et al.* 2003; Grasenick and Low 2004). It is important to an organization because it acts as a multiplying element creating value for the organization by connecting HC and SC with other external stakeholders (Ordóñez de Pablos 2004).

The three IC components are inter-dependent (Subramaniam and Youndt 2005; Youndt *et al.* 2004). Through the combination, utilization, interaction, alignment and balancing of the three types of IC and as well as managing the knowledge flow between the three components, IC renders the best possible value to organizations in the knowledge economy.

As what constitutes the IC components for one organization may not be the same for another (Roos *et al.* 2001; Roos and Jacobsen 1999; Snyder and Pierce 2002), such a unique characteristic is compatible with RBV's four attributes of firm resources: rare, valuable, costly to imitate and non-substitutable. Accordingly, IC is considered context-specific (Bontis *et al.* 1999; Roos and Jacobsen 1999) and investments in IC are likely to be different, depending on the type of organizations (Subramaniam and Youndt 2005). The practical applications and the pragmatic approach of the early IC research

provide a basis for practical managerial tools and methodologies. Therefore, an IC perspective helps to bridge the gap between the conceptual thinking of RBV and a practical approach necessary for the adoption of the framework by managers (Peppard and Rylander 2001a).

Intellectual capital becomes the main differentiating factor that provides a competitive market position to an organization (Kaplan and Norton 2001; Teece 2002). It gives rise to income in a knowledge-based economy as compared with an industrial-based economy (Bettis and Hitt 1995; OECD 1996). In other words, the IC literature has its roots firmly grounded not only in RBV, but also in aspects of KBV of the firm (Peppard and Rylander 2001b).

A number of researchers assert that the concept of IC can be employed for strategic analysis, which can drive organizational strategy (Fletcher *et al.* 2003; Roos *et al.* 2001; Sveiby 2001). Intellectual capital focuses on processes rather than financial results (Edvinsson and Malone 1997). It stresses competence-enhancement but not cash flow improvement (Mouritsen 1998; Roos *et al.* 1997). It concentrates on intangible resources, rather than tangible ones (Klein 1998), and it promotes the creativity possessed by all organizational members to underpin the future non-financial prospects of an organization (Mouritsen 1998; Roos *et al.* 1997; Stewart 1997). In sum, IC is about attempting to balance the transferring and converting of knowledge external and internal to an organization.

Although the IC perspective was first developed as a framework to analyse the contribution of intellectual resources in for-profit organizations, as argued in this paper, the concept of IC is equally relevant to SSNPOs. The next section outlines the importance of IC in the social service non-profit context.

IC in the Social Service Non-profit Context

Intellectual capital is capable of adapting to the challenges posed by the non-profit environment in the knowledge economy because some of the theoretical roots of IC come from

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the internal focus associated with core competence theory (Mouritsen *et al.* 2005). Intellectual capital helps to shift SSNPOs' strategic focus to intellectual resources, including knowledge, skills and experience. This is important to SSNPOs, because strategic activities and changes that are brought to the organizations will be mainly driven by internal initiatives by paid employees and volunteers rather than external forces such as government agencies. Therefore, resistance to those strategic activities and changes by volunteers and employees is likely to be lowered.

In profit-making organizations, profits serve as a simple common language for communication, delegation and co-ordination, and as a means to measure organizational success and benchmark performance (Sawhill and Williamson 2001; Speckbacher 2003). Social service non-profit organizations, however, have no uniformity of financial goals that can be applied as a means of communication to compare goods and services that they produce (Speckbacher 2003). Accordingly, as discussed earlier, SSNPOs are vulnerable under for-profit strategic management techniques which stress cost saving and value for money. Mouritsen *et al.* (2005) emphasize that IC is related to questions about identity, such as 'who you are, and what you want to be' and thus, IC is not merely an objective in relation to intellectual resources, but is an identity crafted around ability and knowledge of what an organization can do (Mouritsen *et al.* 2005; Roos *et al.* 1997). As a result, the IC approach forces non-profit leaders to rethink their mission and their social *raison d'être*. Intellectual capital becomes important to SSNPOs not only because it helps the organizations to avoid goal displacement and resource diffusion, but also because it assists them to refocus their objectives on the social dimensions, which are sometimes distorted by operating in commercial contract environments under the public sector reform movement.

Most organizational resources have either decreasing or increasing returns through their lifetime (Peppard and Rylander 2001b).

For instance, a tangible asset depreciates with use, and each single entity is usually limited to defined tasks (Webster 2000). Intellectual capital, however, does not decrease in value with use. Peppard and Rylander (2001b) argue that IC resources can be used simultaneously by many users in different locations at the same time and, thereby, are non-competitive in an economic sense. This is because, when IC is articulated and challenged, new knowledge may be developed. Thus, IC is often characterized by 'increasing returns' (Peppard and Rylander 2001b, 515); that is, value-generated increases per incremental unit of investment. The non-competitive characteristic of IC is important to SSNPOs because IC may encourage resource sharing rather than resource competition. Intensified competition encouraged by public sector reforms can be destructive to the social service non-profit sector as SSNPOs are competing with each other for resources rather than working together to solve social problems. The non-competitive characteristic of IC also encourages SSNPOs to take advantage of knowledge sharing in the knowledge economy. The knowledge flow between the IC components helps to create a learning culture in SSNPOs for organizational change. This learning culture probably enables the organizations to deal better with new challenges.

Nørreklit (2000) asserts that, if a model is to be effective in an organization, the model must be rooted in the language of the organization's people and communicated to all parts of the organization. This draws another important point that, if a model is to apply in SSNPOs, it must be kept simple and easy to use or disseminate through the whole organization. Bontis *et al.* (1999) argue that IC is flexible and easy to understand, because it represents the collection of intellectual resources and their flows. Accordingly, IC can serve as a simple conceptual framework for SSNPOs that requires relatively little interpretation.

Intellectual capital is important to SSNPOs because it helps to create changes in people's behaviour and values. Roos (1998, 151) argues that, although IC may superficially be concerned

with sales growth and value creation, it has a deeper purpose.

The deeper purpose of an IC approach is to change people's *behaviour*, not least through changing the corporate language. The concept of IC brings with it *a whole set of new values* about what is good and what is bad management, what is the right and the wrong things [sic] to do in corporations. [*emphasis added*]

Values embedded in IC are useful for SSNPOs, particularly in times of today's non-profit environment. Public sector reforms often carry with them values consistent with 'value for money' and competition, causing threats to SSNPOs' traditional qualities such as fulfilling social objectives. Intellectual capital becomes a valid strategic management conceptual framework within the social service non-profit context in the knowledge economy.

On the contrary, failing to account for IC may lead to a misallocation of intellectual resources and run the risk of making poorly informed decisions, which lead to weak strategic planning processes, high employee turnover, inadequate training and development, inexperienced top management teams, and inability to turn data into information in SSNPOs.

In short, as Salamon (1996) argues, in the light of contemporary realities in the non-profit sector, all NPOs urgently require a 'new settlement' to assist them to re-examine their functions, their relationships with citizens, government and business organizations, and the way in which they will operate in the years ahead. This paper argues that the concept of IC can be one of the bases for such as a new settlement which enables SSNPOs to use their knowledge effectively in the competitive non-profit environment.

Finally, research on IC in SSNPOs is particularly relevant at this time not only because it helps us have a better understanding of the strategic management of the organizations in the sector, but also the research is especially germane to the organizations across sectors. Resource scarcity, conflicting stakeholder expectations and a dynamic environment are just

some of the issues that for-profit and public sector organizations face in today's knowledge economy (Stone and Crittenden 1993). Further research on the non-profit strategic management would enhance our understanding of the strategic management of for-profit and public sector organizations in the years ahead.

Conclusion

Knowledge is critical to for-profit organizations as it is to NPOs. As a result of the public sector reform movement, NPOs are forced to change the way they manage and operate their activities. There is more literature pointing to the problems NPOs have in this regard. However, there is relatively little written on what adapted strategic management methods are most appropriate for the pursuit of non-profit activities in today's knowledge economy. Social service non-profit organizations are now urged to use their organizational resources more effectively in the competitive non-profit environment. As argued in this paper, SSNPOs urgently need a competent strategic management framework. This competent strategic management framework must allow the organizations to keep their independence and their ability to pursue social missions, and simultaneously enhance organizational efficiency and effectiveness. The applicability of a number of popular strategic management concepts was examined within the non-profit context. This paper argues that IC is a valid strategic management conceptual framework for SSNPOs. Intellectual capital allows SSNPOs to pursue their social objectives and use their resources effectively; and simultaneously to sustain their cherished qualities. Further research involving specific non-profit sub-sectors and methodologies needs to be carried out to test empirically the findings in this paper.

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Eric Kong is from the School of Commerce, Charles Sturt University, Locked Bag 588, Wagga Wagga, NSW 2678, Australia. E-mail: ekong@csu.edu.au.